

VZCZCXRO1568
RR RUEHDBU
DE RUEHMO #0888/01 0971312
ZNY CCCCC ZZH
R 071312Z APR 09
FM AMEMBASSY MOSCOW
TO RUEHC/SECSTATE WASHDC 2772
INFO RUCNCIS/CIS COLLECTIVE
RHEHNSC/NSC WASHDC
RUCPDOC/DEPT OF COMMERCE WASHDC
RUEATRS/DEPT OF TREASURY WASHDC

C O N F I D E N T I A L SECTION 01 OF 03 MOSCOW 000888

SIPDIS

STATE FOR EUR/RUS, EEB/IFD
TREASURY FOR TORGERSON AND WRIGHT
DOC FOR 4231/MAC/EUR/JBROUGHIER
NSC FOR ELLISON

E.O. 12958: DECL: 04/07/2019

TAGS: ECON EINV EAGR RS BEXP

SUBJECT: ROSTOV'S TROUBLED ECONOMY: IS DIVERSIFICATION THE PANACEA?

REF: A. (A) 08 MOSCOW 3687

1B. (B) 08 MOSCOW 3678

Classified By: Deputy ECON Minister-Counselor John Stepanchuk for reasons 1.4 (b,d)

Summary

11. (C) Rostov-on-Don, a predominantly agricultural region, has a relatively diversified industrial base dominated by the Soviet-era combine manufacturer, Rostselmash. The economic crisis has increased regional unemployment, and many local government officials long for the days of a more autarkic and predictable economy. Nonetheless, some foreign investors such as Coca-Cola and Pepsi-Cola's Lays are investing in the region and have found the oblast administration supportive. While some believe the 2014 Sochi Winter Olympics will have a positive economic effect on the region, including the possibility of a cargo and passenger "hub" airport, small- and medium-sized enterprises find themselves cash-strapped and administratively hamstrung. Young people tend to migrate to Moscow, Western Europe, and even the U.S. for employment. End summary.

A "Diversified" Economy

12. (SBU) Rostov-on-Don is a primarily rural region with a small, but relatively diversified industrial base (Reftel A). It has a few Soviet-era enterprises -- a military helicopter manufacturer, Russia's only electric diesel engine producer, and Rostselmash, Russia's primary combine harvester manufacturer -- all of which have reduced their workforces significantly over the last decade. In addition, the region relies on agriculture, metal processing, and is a trade crossroads with a river port and extensive rail connections. Nevertheless, 2008 unemployment was 6.6 percent and has risen over the last few months. Furthermore, unable to go it alone, Rostselmash persuaded the GOR to raise tariffs on imported agricultural equipment (Reftel B). But even with the competitive advantages of ruble-based pricing and the increased tariffs, Rostselmash still has hundreds of unsold new combine harvesters sitting on its premises as limited financing opportunities force local farmers to delay purchasing new equipment (Septel).

Back to the USSR

¶ 13. (C) Rostov is governed by firm believers in a strong role for the state in the economy. Deputy Minister of Economy, Trade, and Foreign Trade Relations, Valeriy Yevteev, told us he would "not hide" the fact that the oblast's economy was facing many challenges. Nonetheless, he expressed confidence that the region would have a better chance of prospering if more production took place in the oblast so as to reduce dependency on foreign imports. For example, he said that the regional administration was prepared to subsidize pig farms, so that pork would no longer need to be imported. Projects such as these, Yevteev argued, would enable the government to assert greater control over the economy, which would in turn replicate the "virtues" of the Soviet system and its ability to "take care" of people, especially pensioners.

¶ 14. (C) Aleksandr Kolganov, Assistant Representative of the Southern Federal District's branch of the Union of Industrialists (RSPP), made up largely of large corporations with strong government connections, also approved of strong government intervention to prevent the collapse of enterprises. He openly fretted about the growing unemployment in the region and claimed the federal government was not doing enough to protect domestic enterprises.

Many Hopes on Sochi

¶ 15. (C) The Chamber of Commerce and Industry of Rostov Region, which includes more small- and medium-sized business concerns in its membership, was optimistic about the benefits the 2014

MOSCOW 00000888 002 OF 003

Sochi Winter Olympics could bring to regional industry, particularly SMEs. Enumerating the planned improvements to the M4 highway that leads from Moscow to Sochi, via Rostov, Nikolay Prissiyazhyk, President of the Chamber, told us that in addition to the increased employment related to road construction, there would be myriad opportunities for roadside small businesses, such as restaurants and filling stations. Furthermore, plans were afoot to turn a former military airfield just south of Rostov into a "hub" airport "that could someday rival Heathrow". Yury Alexeevsky, Chief of the Chamber's International Relations and Exhibition Board, suggested that this hub could be financed via a public-private partnership. Kolganov indicated, however, that plans were still nascent and that the location had not yet been decided. He told us that it would be better to put the planned airport closer to Novocherkassk, so that redundant workers from that city could have jobs too.

¶ 16. (C) Deputy Economic Minister Yevteev was also optimistic that Sochi would provide a boost to the region's economy. He foresaw a post-Olympics growth in foreign investment, particularly in the food processing and services sectors, following in the footsteps of Coca-Cola and Pepsi-Cola. He acknowledged, however, that the growth in services would have to be accompanied by a major investment in "customer service" training.

Some Foreign Investors See Rostov's Advantages

¶ 17. (C) Major U.S. investors, Coca-Cola and Pepsi-Cola, are attracted to Rostov's agricultural base and its proximity to Sochi and the Black Sea tourist areas. Sergey Shkurnin, Regional General Manager of Coca-Cola HBC Eurasia and Sergey Glushkov, Director of Government Relations of Pepsi-Cola, told us the oblast administration, particularly Rostov's Governor Chub's personal involvement, were instrumental to their decisions to invest in the region. Coca-Cola is setting up a bottling plant, due to start production this June, and wants to be situated near the Black Sea summer market. Joerg Hartmann, Rostov Project Manager of Coca-Cola

HBC Eurasia, told us that doing business in the region necessitated initially "courting" the local authorities, but that once the relationship was established, the oblast administration had been very supportive and helpful in resolving problems. Shkurin expected this close cooperation to be the norm as the project swung into full production over the next couple of years -- a timetable that had extended in light of the downturn.

¶ 8. (C) Pepsi-Cola is setting up its second Lays potato chip factory in Russia, located close to where the potatoes are grown. Glushkov said Rostov oblast won out over the neighboring oblasts of Krasnodar and Stavropol as the site for the plant's location because Governor Chub had personally guaranteed that the oblast would finance and construct all the necessary infrastructure, including connections for water, electricity, sewage, etc. The Lays plant is due to open in the fall.

Small Business: Soviet Business Climate "Easier"

¶ 9. (C) Small business representatives, however, were less enthralled by the oblast administration. Yury Yevchenko of Rostov Club-2015 (a business club) told us that not only was government corruption pervasive, but the banks had put insurmountable conditions on lending, leading some small business owners to conclude that it had actually been easier to do business in Soviet times. Yevchenko further noted that getting banks to refinance loans in the current business climate was futile. Dmitri Larianov, Head of EBRD's Southern Federal District Russia Business Group, told us that Center-Invest (Rostov's second largest bank) had reneged on re-extending a number of loans.

¶ 10. (C) Yury Roshkovan, President of Rostov (fertilizer manufacturer) and OPORA's regional representative, told us that another obstacle to business development was the lack of infrastructure. He pointed out that it was impossible to set up a greenfield site, especially one that might employ more than a handful of people, when there was no nearby social

MOSCOW 00000888 003 OF 003

infrastructure, no reasonable means of reliable public transport, and, most importantly, no utilities. He noted that the oblast did not offer the same deals to local enterprises that foreign multi-nationals received.

¶ 11. (C) Aleksey Morozov, General Director of Vepoz (sausage manufacturing concern), who met with us under the watchful eye of his banker, explained his modest strategy for his 16-year-old company. He had recently bought new sausage producing equipment (which still required a large number of workers at each stage of the sausage manufacturing process) and new lockers for curing his meats. Currently, customer demand was holding, which would enable him to service his loan. But, President Medvedev's anti-corruption drive notwithstanding, Morozov said he had no illusions about an easing of "mandatory" health and safety inspections or a reduction in the bureaucratic hurdles preventing his business from growing or becoming even a regional competitor.

EBRD: Little Potential in the Southern Federal District

¶ 12. (C) EBRD's Larianov was blunt in his assessment that the region's prospects were bleak. He emphasized that the Black Sea coast could never compete with the beaches of Turkey or Egypt's Sharm El-Sheikh, which meant that efforts to turn the district into a tourist destination would not be a good investment. Larianov told us Novorossisk's port (the only deep port in the region) was rife with corruption and resolutely refused to modernize and expand, despite more than a decade of effort on the part of EBRD. The only real

investment opportunities were likely to be found in food processing, agricultural infrastructure, and, possibly, road infrastructure.

Youth Eager Leave Rostov Too

¶13. (C) Similarly, university students and young people were uniformly dismal in their assessments of region's economic prospects. Decrying the paralyzing corruption at all levels of society and the lack of regional employment opportunities, they told us that most youth planned to leave Rostov after graduation, heading primarily for Moscow, but in many cases for the U.S. or Europe.

Comment

¶14. (C) As a city with more than one arrow in its economy's quiver, Rostov-on-Don is a sobering reminder that much infrastructure reform still needs to be done before Russia develops a truly diversified economy. In Rostov's case, corruption and an oppressive bureaucracy are keeping the drivers of development (educated youth and entrepreneurs) from changing the parameters of their economic environment.
End Comment.

BEYRLE